3. The Benchmark Should Include Only The Revenue Associated With The Supported Services

Pacific supports a nationwide average revenue-per-line benchmark, so long as the revenues included are only those revenues collected from residential end-users for the provision of basic exchange services (*i.e.*, basic exchange and EUCL revenue). As explained previously, including revenues from services other than basic exchange service would only serve to perpetuate existing subsidies hidden in the toll and other non-basic service prices. Our formulation will preclude the opportunity for double recovery, and takes into account the range of "affordable" prices customers are paying today. Such a benchmark would be easy to calculate initially from public information and to revise as basic exchange prices change over time.

C. The Commission Must Make Explicit The Size Of And The Precise Method and Formula For Assessing Contributions To The High Cost Fund

Paramount among the omissions in the Joint Board Recommendation is its failure to size properly the high cost fund. This omission understandably results because the Joint Board does not explain fully either the cost model to be used for determining eligibility for withdrawals from the fund or the computation of the benchmark. Nonetheless, by the time the Commission adopts a universal service mechanism, it is essential that the size of the fund be identified in order to determine the appropriate levels of payments and receipts and to enable regulatory commissions and carriers to determine whether the fund is being properly administered.

The task of sizing the high cost fund should be relatively straightforward once the cost of serving a particular area is determined and compared against an appropriate price benchmark. The size of the fund should be sufficient to eliminate the subsidy buried in current prices, consistent with Congress' mandate to make explicit what is now implicit and hidden.

The Joint Board also did not indicate the manner in which assessments on interstate service providers would be calculated. The Commission should explicitly adopt a formula based on gross retail revenues for determining this amount so that these providers can determine their level of payments. Gross retail revenues will provide the simplest, fairest and broadest base for calculating support payments.

D. High Cost Support Should Be Provided for All Residential Lines

The Joint Board recommended that only the first line in a primary residence should be eligible to receive high cost support. ¶ 89. Second lines, it concluded, were not necessary in order to have voice grade service and access to interexchange and information services. The Joint Board also excluded all lines in "second residences." ¶ 90.

The Commission should refuse to adopt these recommendations, and should find that all residential lines should be eligible to receive universal service support. First, Section 254 does not distinguish between first and second residential lines in a household, or between primary residences and "second residences." Therefore, the statute should be interpreted to require high cost funding for all residential lines. Second, this policy will create severe measurement difficulties when a customer obtains lines from multiple carriers because it will be impossible to determine which carrier's line is the "primary" line and which line is located in a "second residence" rather than in the primary residence. Third, with multiple carriers, if the first line obtained is always considered the primary line, a competitive advantage will be accorded to the current provider. Fourth, failure to provide support for additional lines will hinder access to information services since many of these services are now obtained through second lines in the home. Fifth, determining whether additional lines in a single residence actually belong to multiple households, and whether a home is a "second residence," is a nearly impossible task. Accordingly, the Commission should find that all residential lines are eligible for universal service support.

III. PROHIBITING HIGH COST FUND CONTRIBUTORS FROM RECOVERING CONTRIBUTIONS FROM THEIR SUBSCRIBERS IS PATENTLY UNCONSTITUTIONAL AND NOT COMPETITIVELY NEUTRAL

Several parties argued to the Joint Board that universal service support payments should be recovered through a direct assessment on end user bills. ¶ 806. In response to these comments, the Joint Board stated: "[W]e reject commenters' suggestions that support mechanisms be funded through the SLC or a retail end-user surcharge. We find that these mechanisms would violate the statutory requirement that carriers, not consumers, finance support mechanisms." ¶ 812. Standing alone, this statement suggests nothing more than a simple conclusion that Section 254(d) requires that assessments be made directly on providers of interstate services, not directly on end users.

However, in the press conference which followed the Joint Board's adoption of the Joint Board Recommendation, one Joint Board member, Chairman Hundt, suggested that it "wouldn't be 'the right policy or the right way to go' for carriers to pass the assessments on to consumers."[31] Pacific is concerned that this observation represents an unwarranted extension of the Joint Board's conclusion quoted above. Whether or not that is the case, the Commission should not adopt such a policy for three reasons: (1) it would be unconstitutional; (2) it is not authorized by Section 254 or elsewhere in the Communications Act; and (3) it would violate the Joint Board's recommended principle of competitive neutrality.

In fact, the Commission should expressly authorize carriers to pass costs on to their end users as either a separate line item on the bill or by increasing the price of an existing service to cover

[31] "Joint Board Wants $2.5 Billion Education Fund; Disagreement Surfaces Over Intrastate Revenues," *Telecommunications Reports*, November 11, 1996, at 2.

support payments. A mandatory end-user charge is the best method for achieving full and fair cost recovery.[32] To hold otherwise will violate Section 254(b)'s mandate that any support mechanism be explicit. Including a charge on the end user's bill avoids the economic distortions that exist today where subsidies remain hidden from consumers in interstate service providers' rates.

A. Failure To Permit High Cost Fund Contributors From Recovering Their Costs Would Constitute An Unconstitutional Taking

If an explicit universal service funding mechanism is adopted, the Commission is expected to impose a specific charge on providers of interstate services for that purpose. Doing this would cause those providers' costs to rise. Prohibiting carriers from passing along their increased costs to end users would be an unconstitutional taking.

The Takings Clause of the Constitution provides that "private property" shall not "be taken for public use, without just compensation."[33] With or without a physical invasion, below-cost pricing violates the Constitution by requiring, by definition, "confiscatory rates." If, as would be the case here, government regulation forces a party to shoulder disproportionate burdens and costs in the name of the public interest, that party is entitled to payment for those costs and burdens.[34] In fact, historically, the "guiding principle has been that the Constitution protects utilities from being limited to a charge for their property serving the public which is so unjust as to be confiscatory."[35] Accordingly, ILECs must be permitted to recover their universal service costs from their customers.

---

[32] In fact, the California Public Utilities Commission recently adopted an end-user surcharge approach for the state universal service fund because this method makes the support mechanism explicit and sends appropriate economic signals to end users. Decision 96-10-066, at p. 178-182 (Cal. Pub. Util. Com., rel. October 26, 1996).

[33] *U.S. Constitution, Amend. V.*

[34] *Yee v. Escondido*, 503 U.S. 519, 522-23 (1992).

[35] *Duquesne*, 488 U.S. at 307.

B. Failure To Permit Recovery Is Not Authorized By Section 254 Or Any Other Section Of The Act

An agency is required to implement the statutory scheme passed by Congress. Nowhere does Section 254 address how providers of interstate services are to recover the costs of making payments to the universal service fund. At most, Section 254(d) requires only that carriers, in the first instance, be assessed for these payments. Any policy that prohibits a provider of interstate services from recovering these costs from its customers is, therefore, not authorized by Section 254.

Nor is there any support elsewhere in the statute for such a ruling. To the contrary, Section 201(b) generally permits interstate providers to charge just and reasonable rates, which has always been interpreted to permit carriers to recover their costs.[36] And, of course, the Commission has no authority to limit states' authority over the establishment of intrastate rates.[37] Thus, any Commission policy prohibiting recovery of universal service costs would not be authorized.

C. ILECs Would Be Competitively Disadvantaged If They Are Prohibited From Recovering High Cost Fund Contributions From Their Subscribers

The Joint Board recommended that the Commission add an additional principle to govern universal service support policy: the mechanism should be competitively neutral. Failure to permit certain carriers, such as ILECs, to recover universal service costs directly from their end users would be inconsistent with this principle because other, less-regulated providers of interstate services could easily pass along such costs to their subscribers.

---

[36] 47 U.S.C. § 201(b); *See, e.g.*, *Investigation of Access and Divestiture Related Tariffs*, 57 RR2d (P & F) 188, 193, 209 (1984).

[37] 47 U.S.C. § 152(b).

The Commission recently ordered that all nondominant providers of domestic, interexchange services cancel their tariffs within nine months of the effective date of its Order.[38] This will permit these interstate service providers to impose and change rates without meaningful regulatory oversight. The rates for dominant carriers such as the ILECs would, on the other hand, remain subject to pre-effective tariff review, where the Commission would presumably enforce its prohibition against support payment pass-throughs.

Virtually all providers of interstate toll service have been declared nondominant, including AT&T.[39] But, the Commission has not yet determined whether Bell Operating Companies will be nondominant in their provision of domestic, interexchange services,[40] and has not even proposed to consider such regulatory relaxation for access services. The resulting disparity in regulatory treatment will undeniably disadvantage BOCs such as Pacific at the same time that their well-financed competitors are making in-roads into local service markets. Such unfair treatment may not be prescribed under universal service or any other principles of the Act.

IV. THE COMMISSION MAY ASSESS CONTRIBUTIONS BASED ON BOTH INTER- AND INTRASTATE REVENUES

The Joint Board failed to reach a conclusion regarding whether both interstate and intrastate revenues generally should be the basis for calculating interstate telecommunications carriers' contributions to the universal service fund, although it did recommend that both sets of revenues be

[38] *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No. 96-61, *Second Report & Order*, FCC 96-424 (rel. Oct. 31, 1996).

[39] *See Motion of AT&T Corp. to be Reclassified as a Non-dominant Carrier*, 1 CR (P&F) 63 (1995), *petition for recon. pending*.

[40] *See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, *Notice of Proposed Rulemaking*, FCC 96-308 (rel. July 18, 1996).

used for the education/library portion of the fund. ¶ 817. In our view, the Commission has the legal authority to implement a national fund for purposes of universal service based on state and interstate telecommunications revenues of interstate service providers. Section 254 of the Act directs the Joint Board and the Commission to ensure that services are "available at just, reasonable, and affordable rates." 47 U.S.C. § 254(b)(1). A national fund is necessary to ensure "just, reasonable and affordable" rates. While Section 254 appears to contemplate separate funds, it in no way precludes a single fund jointly administered by the states and the Commission, so long as there is a "true up" mechanism based on distributions from the fund which is designed to preserve current jurisdictional assignments.

V. THE COMMISSION SHOULD CLARIFY HOW USERS OF UNBUNDLED ELEMENTS ARE TO BE ASSESSED FOR HIGH COST FUND PAYMENTS

A. The Commission Should Define How High Cost Assistance Will Be Apportioned When Part Of The Network Elements For A Customer Are Provided By The ILEC And Part Are Provided By A CLEC

Where a facilities-based carrier provides unbundled elements to a competitive local exchange carrier, the universal service support should be divided between the ILEC and the CLEC in proportion to the facilities provided by each carrier. Specifically, the subsidy associated with a particular census block group[41] should be apportioned among the major unbundled elements (*e.g.*, switch, line, or local transport), with portions of the support going to each carrier that provides an element. The amount of subsidy available to each carrier should consist of the shortfall of the carrier's revenues over its proxy costs for providing that element of service; where revenues exceed costs, the carrier should remit the excess back to the fund. The subsidy amounts furnished to a carrier will differ depending on what portion of the service the carrier provides. However, the total subsidy for the service will be the same dollar amount as the subsidy for a service provided wholly by one carrier.

[41] It is critical to target support to the census block level, since the cost of basic exchange service can vary tremendously from census block group to census block group. Any averaging across a *large* geographical area will penalize carriers who serve states with a mix of high cost and low cost areas. Only by narrowly targeting subsidy dollars can cream skimming be prevented and an equitable and nondiscriminatory distribution of universal service funds occur. Section 214(e)(5) leaves to state commissions the determination of the appropriate geographic area to be used to measure necessary universal service support.

An illustration of how the subsidy should be allocated follows:

Assumptions:

Proxy cost for relevant Census Block Group = $48
Loop cost = $32
Loop price = $26
Customer Price = $16
Subsidy in CBG = $32 ($48-$16 [*i.e.*, cost minus revenue])

With these assumptions, one can chart the allocation of the subsidy:

Unbundled Elements	Proxy Costs ($)	ILEC Cost ($)	CLEC Cost ($)
Loop	32	32	26
Switch	4	0	4
Other	12	0	12
Total	48	32	42

ILEC Revenues	CLEC Revenues
$26 (link price)	$16 (from cust)

Subsidy need: (Cost-Revenue)
CLEC: $42 - $16 = $26
ILEC: $32 - $26 = $ 6

Total subsidy = $32

Here, a CLEC purchases an unbundled loop from an ILEC for a price of $26. The CLEC is therefore entitled to $26 of the total subsidy of $32, and the ILEC is entitled to the remaining $6. The CLEC has been made whole because the difference between its cost of $42, as indicated in the above chart, and its revenue of $16, is $26; the ILEC has been made whole because the difference between its cost of $32, as indicated in the chart, and its revenue of $26 from the CLEC is $6. In this way, the subsidy can be divided while not increasing the total amount taken from the fund.

B. The Commission Should Clarify Paragraph 808 So That ILECs May Assess Users Of Unbundled Elements For High Cost Fund Contributions

Paragraph 808 of the Joint Board Recommendation states:

> [U]nder the Commission's section 251 rules, ILECs are prohibited from incorporating universal service support into rates for unbundled network elements. We note, however, that carriers are permitted under section 254 to pass through to users of unbundled elements an equitable and nondiscriminatory portion of their universal service obligation.

The Commission should clarify this confusing statement.

The First Interconnection Order concluded that rates for unbundled elements could not include the costs of supporting universal services.[42] To the extent that this simply reflects the fact that universal service subsidy mechanisms must be explicit, rather than hidden, it is understandable and consistent with the Commission's reading of Section 254(d). However, the remaining sentence in the paragraph is ambiguous and should be clarified as follows. Purchasers of unbundled elements should be permitted to be charged for universal service contributions to the extent that they are also providers of interstate services. Such charges should be separately stated and assessed in a nondiscriminatory manner.

VI. THE COMMISSION SHOULD NOT CAP INTERSTATE SUBSCRIBER LINE CHARGES, AND SHOULD ENSURE THAT IF THE CARRIER COMMON LINE CHARGE IS REDUCED OR ELIMINATED, IT IS MADE A PART OF THE UNIVERSAL SERVICE FUND

A. The Joint Board's Proposed SLC Reductions Will Increase Implicit Subsidy, Contrary to the 1996 Act

We support the Joint Board's conclusion that current rates are largely affordable, as demonstrated by current subscription rates. ¶¶ 133 & 769. However, we disagree with the Joint

[42] *First Interconnection Order*, at ¶ 712.

Board's recommendation that the cap on Subscriber Line Charges ("SLCs") be reduced if contributions to the universal service fund are based on both inter- and intrastate carrier revenues. ¶ 772.

The Board's rationale that the SLC impacts affordability is flawed because affordability is a highly individual judgment, and nothing in the record demonstrates that affordability would be affected negatively by retaining the current SLC cap. *See* ¶¶ 126 *et seq.* (listing numerous factors *other than rates* that have an impact on affordability). For those low-income customers most affected by moderate rate changes, the proposed expansion of low-income support programs should ameliorate any negative impact. ¶¶ 379 *et seq.* (recommendations for low-income customers).

A reduction in the SLC would perpetuate and indeed expand the current system of subsidy by shifting the burden for support of universal services -- which are *end-user services* -- to other services. If the Joint Board's recommendation is adopted, basic service costs not recovered through the SLC will be shifted to the CCL, because the CCL recovers those loop costs the SLC does not recover.

This proposed SLC rate adjustment does not meet the requirement that recovery of universal service costs be non-discriminatory. ¶ 2. Local exchange carriers recover CCL charges only from purchasers of *access*, largely IXCs. In addition, as the Joint Board points out, competitive entrants need not comply with the mandated Common Line rate structure imposed on ILECs. ¶ 770. Without an adequate end-user surcharge structure, competitive entrants will be free to recover universal service funding costs from any place the market will bear, while ILECs will be required to implement end-user rate reductions and access charge increases. This scheme is far from equitable or competitively neutral, contrary to the Act's requirements. *See* ¶¶ 2 & 23, citing 47 U.S.C. § 254(b)(7).

The Joint Board compounds the problem by recommending that CCL reductions arising from its changes to the Long Term Support ("LTS") program,[43] and the Commission's earlier decision to remove the payphone element of the CCL, should reduce *both* SLC and CCL charges. The SLC is *not* a subsidy mechanism: it is assessed against cost causers -- end users -- to compensate for their use of the local loop. The CCL, on the other hand, recovers costs attributable to end users from purchasers of access.

As noted above, reducing the *SLC* will place ILECs at a competitive disadvantage, and is unnecessary to ensure continued affordability in local rates. We agree, however, that reductions in the *CCL* due to the deregulation of the pay telephone business and removal of LTS are appropriate, because the CCL is where costs previously attributed to payphones and LTS were recovered.

B. <u>The Carrier Common Line Charge Must Be Made An Explicit Part of the Universal Service Fund If It Is Lowered by The Commission</u>

If the Commission reduces or eliminates the CCL charge in this or other proceedings, it must make up for these reductions in the universal service fund. We are surprised that the Joint Board was unable to conclude that the CCL is a true universal service support mechanism. ¶ 774. We continue to believe that the CCL is a mechanism for recovering the cost of *end user basic services* by charging them to purchasers of *access*. The loop is required for end-user services regardless of whether or not the user ever makes a toll call. Further, the loop is a major component of "voice grade access to the public switched network," which the Joint Board identifies as a supportable aspect of universal service. ¶¶ 4 & 383. Thus, any changes to the CCL that come about as a part of this or other

[43] We support the Joint Board's conclusion that LTS constitutes a universal service support payment and should be recovered on a non-discriminatory basis. ¶ 767.

proceedings should be transformed into an explicit subsidy and made a part of the universal service fund.

On an interim basis, until the Commission deals with the CCL either in the context of access reform or universal service, we support the Joint Board's endorsement of flat-rated per line CCL charges as a more efficient form of assessing the CCL than the current method. ¶ 776. In the long run, however, access charges should be made a part of universal service. To the extent access charges are reduced without offsetting increases -- either in this proceeding, the upcoming access reform proceeding or elsewhere -- universal service funding should be increased to account for any shortfall.

VII. THE JOINT BOARD'S LOW-INCOME PROPOSALS WILL NOT ENHANCE SUBSCRIBERSHIP AND WILL INCREASE BAD DEBT; THE COMMISSION SHOULD INSTEAD RELY ON MARKET-DRIVEN INDUSTRY INITIATIVES

A. We Support Voluntary Toll Limitation Services, If They Are Supported By The Fund

We agree that voluntary toll limitation services for low-income customers are a useful means of keeping "at-risk" customers on the network while limiting the risk of non-payment of long distance calls and disconnection for non-payment.[44] We also agree with the Joint Board that carriers providing toll limitation service as part of their Lifeline packages should recover their costs from the universal service fund. ¶ 385 ("We further recommend that carriers offering voluntary toll-limitation services receive support based on the incremental cost of providing those services.").

---

[44] Pacific already offers toll restriction services to its customers for up to six month periods subject to certain conditions. The service allows customers to retain basic local service without the ability to make 1+ dialed calls, rather than being disconnected for non-payment. Pacific also offers toll restriction to qualified disconnected customers with outstanding balances as a substitute for immediate payment or a deposit for reconnection. Pacific's toll blocking service is identical to toll restriction except that it is voluntary, has no time limitation, and incurs a monthly recurring charge of $2.00. The Joint Board incorrectly states that Pacific offers "toll control" service. ¶ 385 n.1284. Pacific's toll limitation services are limited to the two services we describe here.

In addition to costs associated with each customer's toll limitation services, we advocate that carriers receive recovery for their *start-up costs* for initiating the toll-limitation program, as well as *lost revenue* reimbursement. We define lost revenue as the amount the customer would normally pay for voluntary toll blocking service -- in Pacific's case, $2.00 per customer. This charge covers incremental costs and a portion of joint and common costs associated with the service. If we receive this amount from the universal service fund, we will be made whole for our costs of providing toll limitation services.[45]

B. <u>We Oppose A Rule Prohibiting Disconnection for Non-Payment of Toll</u>

We do not agree that the Commission may preclude LECs from disconnecting telephone service for non-payment of toll charges, as the Joint Board recommends. ¶ 387. The Joint Board bases its recommendation on erroneous assumptions about the effect of a no-disconnect policy on subscribership. The competitive marketplace[46] and targeted voluntary programs such as those Pacific has implemented will better serve to maximize subscribership levels. The Commission should focus on front-end solutions that help customers control their calling and manage their debt before they ever reach the point of disconnection. The no-disconnect rule is a back-end solution that will cause levels of bad debt in the toll market to skyrocket and encourage irresponsibility in toll calling. If the Commission implements a no-disconnect rule, it should liberalize the process for a carrier with

---

[45] In the alternative, we propose that we receive an exogenous cost adjustment to cover our costs of implementing the low income provisions of Section 254 and any other provisions that require infrastructure upgrades and other similar investment in order to meet Commission mandates.

[46] The Joint Board's proposal to implement a rule prohibiting carriers from disconnecting service for non-payment of toll will not only hurt the competitive marketplace by increasing its bad debt, it also discriminates against carriers who bill for both local and long distance service. If local and long distance charges are provided by separate companies on separate bills, the non-payment of long distance changes does not affect local charges.

effective voluntary toll control programs to obtain a waiver of the rule. Finally, we do not believe that the Commission has jurisdiction to mandate a no-disconnect rule. We discuss these issues in greater detail below.

1. The No-Disconnect Rule Will Not Increase Subscribership

The Joint Board's recommendation assumes, erroneously, that declining penetration rates can be traced to disconnections for non-payment of toll. ¶ 387. In fact, research shows that many states have below average penetration rates even though they have a prohibition on disconnection for non-payment of toll charges, and some states have above average penetration rates without a no-disconnect policy.[47]

The Joint Board cites *1994* data in support of its conclusion; however, the *1995* data changed in such a way as to cast doubt on the conclusion drawn from the 1994 data. For example, in 1995, Pennsylvania, one of the first states to implement a no-disconnect rule, was no longer the nation's leader in penetration; it had declined to seventh. Pennsylvania was eighth in penetration rates a decade ago, before it had a no-disconnect policy. Those states with subscribership levels above the national average in 1995 were about evenly split as to whether they had no-disconnect requirements. Thus, there is no clear "correlation" between a no-disconnect policy and subscribership rates.

[47] *See, e.g., In the Matter of Amendment of the Commission's Rules and Policies to Increase Subscribership and Usage of the Public Switched Network*, CC Docket No. 95-115, Reply Comments of Pacific Bell and Nevada Bell, filed November 14, 1995, at 11-13 & n.26 (describing, among other things, high (at or above 93.9%) penetration levels in 15 states without a no-disconnect rule, including California).

2. <u>Pacific Has Improved Subscribership Rates Through Creative Partnerships With Community Leaders and Outreach Programs; It Should Also Be Allowed To Develop Flexible Solutions To Help Customers Control Toll Use</u>

Pacific's own voluntary, market-driven initiatives have had very positive impacts on subscribership, and the Commission should not impose regulatory solutions that will not have an appreciable impact on penetration. The demographics of California have given Pacific a unique opportunity to develop niche marketing programs. Pacific's service representatives communicate in seven languages in addition to English. Pacific has ongoing programs to help "at-risk" communities stay connected to the network.

For example, Pacific's proposed merger with SBC includes an innovative "Community Technology Fund"[48] that will be used for a variety of purposes, including telecommunications network infrastructure, communications services, customer equipment, training, technical assistance, and consumer education and advocacy. The fund will also support creation of a consumer-oriented "think-tank" which can conduct research studies, addressing the vital interests of underserved communities and the general public. In addition, Pacific Bell will create a "Universal Service Taskforce," in which community leaders will recommend ways to increase telephone subscribership in underserved communities. The Commission should leave it to carriers and individual states to devise means of increasing subscribership, so that solutions are closely targeted to the needs of particular communities.

[48] A press release describing the Community Technology Fund in more detail is attached hereto as Exhibit A.

In addition, the 1996 California Affordability Study[49] indicates that both customers and non-customers in California's low telephone penetration areas are interested in using *flexible* call control services. Customers want services such as pre-paid service and credit limits which allow them to choose a monthly toll cap, rather than outright toll limitations. A plan which allows customers to limit their toll exposure at the front end, rather than prohibiting them from making all toll calls or requiring carriers to absorb unpaid bills at the back end, will more carefully target the problem. The Commission should allow carriers to devise specific solutions targeted at their own customers, rather than dictating a regulatory approach that will not increase subscribership.

3. The No-Disconnect Policy Will Increase Drastically the Industry's Net Bad Debt and Increase Our Operational Expenses, and We Will Not Be Adequately Protected by Toll Limitation Services

The policy against disconnection for non-payment of toll will increase drastically the net bad debt of the industry. Indeed, the percentage of bad debt has multiplied in states that have implemented a no-disconnect rule.[50] A rise in bad debt will increase prices in the long term for all subscribers.

Based on discussions with IXCs and other carriers, we estimate a $75 million increase in IXC net bad debt associated with IXC accounts for which Pacific does the billing. If the Commission adopts the no-disconnect rule, it must increase the universal service fund to cover the associated increase in bad debt. *See* ¶ 419 (proposing an increase in federal support for Lifeline).

---

[49] We submitted the affordability study with our opening comments in Docket 95-115. See subsequent footnote for citation.

[50] *See, e.g., In the Matter of Amendment of the Commission's Rules and Policies to Increase Subscribership and Usage of the Public Switched Network,* CC Docket No. 95-115, *Comments of Bell Atlantic,* filed September 27, 1995, Appendix.

In addition, our systems will need to be significantly redesigned to accommodate the proposed policy. Our collections systems do not distinguish between toll and non-toll charges.[51] When we last examined the potential expense of implementing a no-disconnect rule, we estimated that it would cost us millions of dollars to upgrade our billing and collection systems.[52] We estimated that there would be substantially increased customer contact time needed to explain and implement the prohibition. We conservatively estimated an increase in our costs of over *$22 million annually* for 450 additional collection representatives. We would expect reimbursement of these associated collections cost from the fund as well, or an exogenous cost adjustment designed to compensate us for these upgrades.[53]

Even if we incur this expense, however, toll limitation and blocking services will not afford us sufficient protection against runaway toll bills. While we can technologically block direct-dialed originating interstate calls, we cannot use technology selectively to block interstate terminating calls, such as collect calls and interstate billed-to-third-number calls, charged to specific customers. We also cannot use technology selectively to block calls to 800 information services, or to selectively block access to an IXC's 800 call completion platform. While our Line Identification Database ("LIDB") system might be used in blocking these calls, IXCs do not validate all calls through LIDB.

---

[51] Other operational difficulties will also arise: for example, if we receive partial payments from customers, it is not clear to which service -- local, intraLATA or intrastate toll, or interstate -- we should apply the payment.

[52] *In the Matter of Amendment of The Commission's Rules and Policies To Increase Subscribership and Usage of the Public Switched Network,* CC Docket No. 95-115, *Comments of Pacific Bell and Nevada Bell on the Notice of Proposed Rulemaking,* filed September 27, 1995, at 18.

[53] Pacific seeks this exogenous cost adjustment pursuant to 47 C.F.R. Section 61.45(d)(1). Pacific will incur these additional costs only because of a regulatory requirement, and there will be no opportunities to minimize the costs associated with complying with the regulation. For the same reasons, Pacific should be entitled to an exogenous cost adjustment for other expenses it incurs in complying with Commission-mandated requirements pursuant to Section 254.

Thus, even with toll limitation and toll blocking, chargeable toll calls will continue to get through and may never be paid for.

4. The Standards for Obtaining A Waiver Should Be Relaxed

We agree with the Joint Board that waivers of the Commission's no-disconnect policy should be allowed. ¶ 388. However, the criteria the Board lists for obtaining a waiver are unclear, and in our view should be relaxed so that carriers which offer liberal, voluntary toll limitation programs are exempt from the no-disconnect rule. The Board proposes a waiver where the carrier "offers toll-limitation to its Lifeline subscribers at no charge." *Id.* The Commission should clarify that services which are "equivalent" to those the Joint Board recommends -- such as Pacific's -- will meet this requirement.

The Commission should eliminate the third waiver criterion, which requires that "telephone subscribership among low-income consumers in the carrier's service area [be] at least as high as the national subscribership level for low-income consumers." *Id.*[54] This prong could preclude carriers in states with low penetration rates from ever obtaining a waiver of the no-disconnect requirement. If the Commission leaves this prong in, it should require that the difference between the national subscribership level and the level in the carrier's service area be *material* -- at least 3 percentage points different.

5. The Commission Lacks Authority to Require a No-Disconnect Policy

Finally, we do not believe that the Commission has authority to implement a rule prohibiting disconnection of *local* service for non-payment of *interstate* charges. Moreover, nothing in Section 254 gives the Commission authority to prohibit disconnections for non-payment of toll;

[54] Indeed, local competition on the rise, it will be increasingly difficult to define and measure subscribership rates in a carrier's "service area."

Section 254 is entirely silent on the issue. Indeed, the Joint Board proposal goes beyond the intent of Section 254 of affording universal access to telephone service by attempting, without factual support, to devise a means for customers who have such access to remain on the network regardless of the consequences to the industry. This proposal goes too far, in our view.

VIII. WE SUPPORT MANY OF THE JOINT BOARD'S PROPOSALS FOR SCHOOLS AND LIBRARIES, BUT OPPOSE INCLUSION OF THE INTERNET AND INTERNAL CONNECTIONS

We applaud the Joint Board's work designed to ensure access to telecommunications for the nation's schools and libraries. We have long been strong proponents of technology in schools, and have engaged in numerous private initiatives, such as our Education First program, to ensure that schools advance into the Information Age. We agree with many of the Joint Board's proposals regarding the lowest corresponding price and discounts. However, we disagree that the Commission has the authority to order that the Internet and "internal connections" be included among the services funded by universal service. We also seek clarification on the relationship between state and federal universal service programs in the area of education.

A. The Joint Board's Recommended Method For Subsidizing Internet Access Is In Conflict With Section 254, Ignores The Current Subsidy, And Would Further Skew Access Pricing

1. Section 254 Does Not Allow Directly Subsidized Discounts For Internet Access Service

The Joint Board recommends that the Commission provide discounts for Internet access for schools and libraries pursuant to Section 254(h)(2). ¶ 462. The Board rejects arguments by us and others that, although actions taken pursuant to Section 254 can encourage the use of Internet access, Internet access itself cannot directly receive universal service support because it is an unregulated information and enhanced service. *See* ¶¶ 455-56. The Joint Board states: "[W]e are not inclined to recommend, at this time, that the Commission single out the transmission component of Internet access from the information service component. We find it is neither necessary nor appropriate to make findings regarding the regulatory treatment or classification of Internet access within this proceeding."

The Joint Board misapprehends both the status of the Commission's current regulatory treatment and classification of Internet access and the universal service support requirements of Section 254. First, the Commission has already determined that Internet access is an unregulated enhanced service, and has required BOCs, in their Comparably Efficient Interconnection Plans, to "single out" the telecommunications services used to provide Internet access.[55] In terms of the Act, Internet access also is an unregulated information service, since enhanced and information services have long been treated as essentially the same.[56]

Second, enhanced/information services, including Internet access services, cannot receive support under Section 254. Support is limited to "telecommunications services" that meet certain standards (Section 254(c)(1)), and "only an eligible telecommunications carrier designated under Section 214(e) shall be eligible to receive specific Federal universal service support." 47 U.S.C. § 254(e). The limitation to "telecommunications carriers" is expressly restated with regard to schools and libraries in Section 254(h)(1)(B). The Act defines "telecommunications services" separately from "information services," and to the extent that an entity provides information services, it is not a "telecommunications carrier" under the Act (*see* Sections 3(20), (44), & (46)). Thus, an Internet access provider is not eligible for support.

---

[55] See *Bell Operating Companies Joint Petition for Waiver of Computer II Rules*, 10 FCC Rcd 13758, ¶¶ 65-67 (1995) ("*1995 BOC CEI Plan Approval Order*"), in which the Commission approved Pacific Bell's CEI plan that included Internet access.

[56] Prior to the 1996 Act, the MFJ used the term "information services," and the Commission used the term "enhanced services" for essentially the same types of services.

Contrary to the Joint Board's position, Section 254(h)(2) does not modify these limitations with respect to schools and libraries. ¶ 460. In fact, implementation of this section requires these limitations. The Joint Board points out that Section 254(h)(1)(B), concerning support of services for schools and libraries, limits mandated discounts and the receipt of support from the fund to telecommunications carriers. The Joint Board, however, states, "Section 254(h)(2)(A) provides a broader framework for facilitating deployment of services to schools and libraries because the competitively neutral rules contemplated under that section are applicable to all service providers."

The Joint Board misconstrues the wording of this section, which states that "[t]he Commission shall establish competitively neutral rules . . . to enhance . . . access to advanced telecommunications and information services" to schools, health care providers, and libraries. Competitively neutral rules require that the category of service providers and services that receive support be the same as the category of service providers and services that provide support. Otherwise, one type of provider and service would be favored over another. The section's reference to "access to advanced telecommunications and information services" recognizes that telecommunications services offered by telecommunications carriers are used for access not only to other telecommunications services but also to information services and that competitively neutral rules are needed for that access. Competitively neutral payments and funding for discounts on telecommunications services could stimulate broader access to information services, but information services themselves cannot be directly subsidized.

The confusion in the Joint Board's recommendation appears to arise from its failure to recognize that "Internet access service" is a term of art used by parties and the Commission for an enhanced/information service provided by information service providers. Telecommunications services, provided by telecommunications carriers, are used to provide network "access" or interconnection to the "Internet access service." The telecommunications carriers contribute to the universal service fund and can obtain support from that fund for discounts on their telecommunications services. The ISPs (including Internet access service" providers) do not contribute to the fund and cannot obtain support from it.

Congress's concern in Section 254(h)(2)(A) with how telecommunications carriers provide telecommunications service is made clear in subsection (B) of the same section, which requires the Commission to "define the circumstances under which a *telecommunications carrier* may be required to connect its network to such public institutional telecommunications users." (Emphasis added.) Moreover, the Joint Board itself does not assert that the section includes more than "telecommunications services." It states that the "discounting of *telecommunications services* under Section 254(h)(2)(A) will enable schools and libraries to have access to the broadest array of services possible" and that they need "full flexibility among *telecommunications services* . . . ." (Emphasis added.) Nonetheless, the Joint Board's recommendation for eligible services includes non-telecommunications services.

The Joint Board's recommendation to include Internet access services as recipients of support is caused by its incorrect assumption that the Commission need not, and should not, be concerned about "the regulatory treatment or classification of Internet access within this proceeding." That erroneous position, in turn, is caused by its failure to recognize that to the extent an entity is an information service provider it does not provide telecommunications services but instead purchases them from a carrier for interconnection of the information service.[57] ¶ 464. The Commission should

[57] *See, e.g.*, *1995 BOC CEI Plan Approval Order*, ¶¶ 65-67 (concerning the Commission's description of the use of tariffed network services by Pacific Bell's Internet access service).

reject these mistaken positions and leave Internet access out of the list of services eligible for direct support from the universal service fund.

2. <u>In Order To Avoid Further Skewing Of Access Subsidies And Pricing, The Commission Must Consider The Relationship Between The Joint Board's Recommendation And The Existing Access Charge Exemption Enjoyed By Enhanced Service Providers</u>

The Joint Board's mistakes concerning the nature of both telecommunications and information services result in its incorrect recommendation on discounts. Adoption of that recommendation would create a new subsidy for Internet access providers without addressing the existing implicit subsidy that LECs provide to them through the Commission's Enhanced Service Providers ("ESPs") exemption from access charges. The inefficiency and inequity of the current structure would be increased, to the detriment of all users of the network.

The Joint Board recommends that discounted Internet access "include the communications link to the [Internet Service Provider ("ISP")], whether through dial-up access or via a leased line, and the subscription fee paid to the ISP, if applicable. The discount would also apply to electronic mail." ¶ 463. The discount would not include additional, separate information content services. "Schools and libraries, however, would be permitted to apply the discount to the entire 'basic' charge by an ISP that bundled access to some minimal amount of content, but only under those circumstances in which the ISP basic subscription charge represented the most cost-effective method for the school or library to secure non-content conduit access to the Internet."

The Joint Board's description of the subscription fee of an ISP as only sometimes being applicable for a subsidized discount under the proposal is incorrect. ISPs would consistently obtain this subsidy if the Commission adopts the Joint Board's recommendation. This would be the result because Internet access service is offered to end users, including schools and libraries, as a package that includes charges to cover both the ISP's enhanced functionality and the underlying basic network services that the ISP has purchased from carriers for interconnection of the enhanced service.[58] The Commission should reject this proposal for an explicit, direct subsidy of ISPs.

ISPs already are enjoying an implicit subsidy for many of the underlying basic network services that they purchase from LECs and include in the service packages they offer. In 1983, the Commission exempted all ESPs from paying access charges to LECs, as a "transition to avoid . . . rate shock" and in response to arguments that enhanced services constituted an "infant" industry that needed protection.[59] The exemption requires that ESPs be allowed "to take local business lines, or other state-tariffed arrangements, instead of federal access, in the same manner as other end users."[60] However, ESPs do not use these local business lines in the same manner as other end users or in the way the local services were designed and priced to be used. ESPs do not use the lines for originating calls, but for terminating traffic in response to incoming messages from their customers. Our local business lines, however, do not include any charges for terminating usage. ESPs' traffic not only differs in traffic flow, but also in duration and quantity. For instance, Internet access providers using Pacific Bell's network have an average call duration approximately seven times greater than the average duration for all Pacific Bell's customers, and the average peak-hour usage is approximately

---

[58] If the ISP provides its own underlying network services, it is to that extent a telecommunications carrier and should be contributing to the universal service fund.

[59] *MTS and WATS Market Structure*, CC Docket No. 78-72, 97 FCC 2d 682, 715 (1983). ESPs can use local business lines to escape paying access charges for providing service to customers who use dial-up access, rather than Frame Relay or other high-speed packetized data or private line services for which interstate switched access charges are not applicable. Section 254 is limited to public and non-profit elementary and secondary schools and libraries, most of which use, or are expected to use, dial-up access for the foreseeable future. The ESP exemption gives ESPs the incentive to use local business services and, thus, to avoid encouraging customers to use high-speed private line alternatives.

[60] *Filing and Review of Open Network Architecture Plans*, CC Docket No. 88-2, Phase I, 4 FCC Rcd 1, 165-66 (1988).